



Rating
Hold

Asia
China

Consumer
Hotels / Leisure /
Gaming

Company
Huayi Brothers

Reuters 300027.SZ Bloomberg 300027 CH Exchange SHZ Ticker 300027

Date
10 November 2015

Initiation of Coverage

Price at 9 Nov 2015 (CNY)	39.72
Price target - 12mth (CNY)	40.00
52-week range (CNY)	63.58 - 25.77
HANG SENG INDEX	22,727

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Entertainment kingdom – initiating with Hold

Huayi Brothers actually is a brand

We initiate coverage of Huayi Brothers with a Hold rating and a target price of RMB40. We differ from the market's view of the company as a pure movie maker, preferring to view it as a fully integrated diversified entertainment production house. Leveraging off its strong brand franchise, the company is able to fully monetise its films in the secondary post-production segments, such as theme parks and online video games. We regard the stock as fairly valued and initiate at Hold.

Movies still the root to nurturing the "Huayi" brand

Huayi's 1H15 movie business grew 57% YoY, thanks to the strong box-office revenues from its nine popular movies. We think Huayi's fundamental growth is still driven by its movie-related business: 1) movies; 2) talent agencies; 3) cinemas. Although we are concerned about the instability of the movie-making business as a whole, we believe Huayi's focus on movies enables the company to maintain its brand, rather than leveraging in other areas.

Online gaming growing, and brand licensing has high margins

Based on its strong "Huayi" brand, the company has expanded into brand licensing and the internet gaming business. The revenue contribution from the two businesses increased to 10% and 33% in 2014, respectively, from 2% and 1% in 2013. The brand licensing business is a zero-cost game, with a 100% gross margin, as the business is developed on the IP created from movie production. Internet gaming is a high-growth segment, which we expect to register a 31% revenue CAGR over 2016-18, and which we believe could help the company to extend its product chain further and improve its IP utilisation.

Valuation – RMB40 target price, DCF-based (8.5% WACC, 4% TGR); risks

Huayi is trading at 49x 2016E core EPS, implying 1.6x PEG on our two-year earnings CAGR – fully valued, we believe. Downside risks: less favourable government policies; intensified competition; China piracy issues; lower-than-expected returns from films/TV dramas; production delays; new business uncertainty. Upside risks: better-than-expected box-office performances.

Price/price relative



Performance (%)	1m	3m	12m
Absolute	0.4	0.4	69.5
HANG SENG INDEX	1.2	-7.4	-3.5

Source: Deutsche Bank

Forecasts And Ratios

Year End Dec 31	2013A	2014A	2015E	2016E	2017E
Sales (CNYm)	2,014.0	2,389.0	3,388.9	4,438.7	5,668.7
EBITDA (CNYm)	653.2	937.4	1,225.6	1,607.6	2,047.5
Reported NPAT (CNYm)	590.2	896.7	1,201.9	1,114.5	1,412.7
Reported EPS FD(CNY)	0.49	0.73	0.91	0.80	1.02
DB EPS FD(CNY)	0.36	0.52	0.59	0.80	1.02
DB EPS growth (%)	97.1	45.8	13.2	36.0	26.8
PER (x)	50.9	47.4	67.3	49.5	39.0
EV/EBITDA (x)	30.0	31.0	41.4	31.3	24.3
DPS (net) (CNY)	0.10	0.10	0.12	0.11	0.14
Yield (net) (%)	0.5	0.4	0.3	0.3	0.4

Source: Deutsche Bank estimates, company data

¹ DB EPS is fully diluted and excludes non-recurring items

² Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

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Model updated: 09 November 2015

Running the numbers

Asia
China
Hotels / Leisure / Gaming

Huayi Brothers

Reuters: 300027.SZ Bloomberg: 300027.CH

Hold

Price (9 Nov 15) CNY 39.72
Target Price CNY 40.00
52 Week range CNY 25.77 - 63.58
Market Cap (m) CNYm 55,153
 USDm 8,671

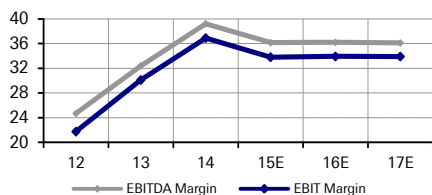
Company Profile

Huayi Brother mainly involves in the production and distribution of films and TV dramas.

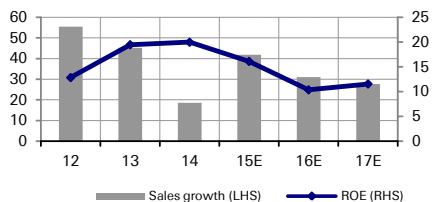
Price Performance



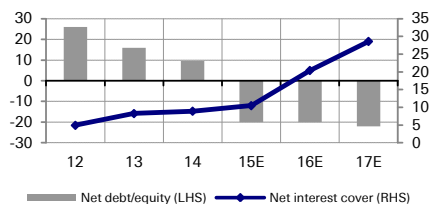
Margin Trends



Growth & Profitability



Solvency



Fiscal year end 31-Dec

Financial Summary

	2012	2013	2014	2015E	2016E	2017E
DB EPS (CNY)	0.18	0.36	0.52	0.59	0.80	1.02
Reported EPS (CNY)	0.20	0.49	0.73	0.91	0.80	1.02
DPS (CNY)	0.08	0.10	0.10	0.12	0.11	0.14
BVPS (CNY)	1.8	3.3	4.1	7.1	8.3	9.3
Weighted average shares (m)	1,210	1,210	1,226	1,315	1,389	1,389
Average market cap (CNYm)	8,890	22,035	30,319	55,153	55,153	55,153
Enterprise value (CNYm)	8,472	19,617	29,029	50,719	50,368	49,850

Valuation Metrics

P/E (DB) (x)	40.5	50.9	47.4	67.3	49.5	39.0
P/E (Reported) (x)	36.4	37.3	33.8	43.5	49.5	39.0
P/BV (x)	4.01	8.47	6.48	5.58	4.76	4.29
FCF Yield (%)	nm	1.9	nm	nm	1.1	1.4
Dividend Yield (%)	1.0	0.5	0.4	0.3	0.3	0.4
EV/Sales (x)	6.1	9.7	12.2	15.0	11.3	8.8
EV/EBITDA (x)	24.7	30.0	31.0	41.4	31.3	24.3
EV/EBIT (x)	28.1	32.3	32.9	44.3	33.4	25.9

Income Statement (CNYm)

Sales revenue	1,386	2,014	2,389	3,389	4,439	5,669
Gross profit	702	1,008	1,455	2,030	2,664	3,402
EBITDA	342	653	937	1,226	1,608	2,048
Depreciation	34	44	50	62	74	87
Amortisation	7	2	6	18	28	37
EBIT	302	607	882	1,146	1,506	1,923
Net interest income(expense)	-61	-73	-99	-109	-74	-67
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinary	-43	-84	-30	40	0	0
Other pre-tax income/(expense)	123	349	526	714	248	274
Profit before tax	321	797	1,279	1,791	1,681	2,130
Income tax expense	80	200	245	343	322	408
Minorities	-4	8	138	246	245	310
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	244	590	897	1,202	1,114	1,413
DB adjustments (including dilution)	-25	-158	-257	-425	0	0
DB Net profit	219	433	639	776	1,114	1,413

Cash Flow (CNYm)

Cash flow from operations	-249	511	-21	-33	735	925
Net Capex	-141	-99	-72	-96	-116	-137
Free cash flow	-390	413	-93	-129	619	787
Equity raised/(bought back)	0	0	277	3,600	0	0
Dividends paid	-91	-164	-220	-124	-167	-154
Net inc/(dec) in borrowings	893	579	296	-92	-31	426
Other investing/financing cash flows	-302	-321	427	-685	-111	-114
Net cash flow	110	496	687	2,569	310	945
Change in working capital	-510	144	-754	-1,424	-555	-680

Balance Sheet (CNYm)

Cash and other liquid assets	642	1,137	1,829	4,398	4,708	5,653
Tangible fixed assets	273	317	354	388	431	481
Goodwill/intangible assets	33	355	1,560	1,796	2,539	2,535
Associates/investments	974	3,067	2,479	2,988	2,998	2,998
Other assets	2,217	2,336	3,596	5,322	6,241	7,353
Total assets	4,138	7,212	9,819	14,893	16,918	19,020
Interest bearing debt	1,193	1,770	2,376	2,284	2,252	2,679
Other liabilities	820	1,484	1,763	2,051	2,402	2,820
Total liabilities	2,013	3,254	4,139	4,334	4,655	5,499
Shareholders' equity	2,120	3,942	5,037	9,890	11,594	12,852
Minorities	5	16	643	669	669	669
Total shareholders' equity	2,125	3,958	5,680	10,559	12,263	13,521
Net debt	552	633	547	-2,115	-2,456	-2,975

Key Company Metrics

Sales growth (%)	55.4	45.3	18.6	41.9	31.0	27.7
DB EPS growth (%)	16.2	97.1	45.8	13.2	36.0	26.8
EBITDA Margin (%)	24.7	32.4	39.2	36.2	36.2	36.1
EBIT Margin (%)	21.8	30.1	36.9	33.8	33.9	33.9
Payout ratio (%)	37.1	20.5	13.7	13.1	13.9	13.9
ROE (%)	12.8	19.5	20.0	16.1	10.4	11.6
Capex/sales (%)	10.2	4.9	3.0	2.8	2.6	2.4
Capex/depreciation (x)	3.5	2.1	1.3	1.2	1.1	1.1
Net debt/equity (%)	26.0	16.0	9.6	-20.0	-20.0	-22.0
Net interest cover (x)	4.9	8.3	8.9	10.5	20.4	28.6

Source: Company data, Deutsche Bank estimates

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Investment thesis

Outlook

We initiate coverage on Huayi Brothers, one of the leading film producers in China, with a Hold rating and a target price of RMB40.

Building up from film production, Huayi Brothers has accumulated several valuable assets, and is evolving into a comprehensive mass-media company that does not depend solely on volatile film production returns. Huayi Brothers has developed a well-rounded business structure. We expect the company to achieve 13% yoy and 36% yoy EPS growth in 2015 and 2016, respectively.

- **Downstream theatre operation.** The company established theatre management companies, and currently has 15 theatres under operation.
- **Brand licensing for post-theatrical revenue.** Huayi Brothers has built strong brand equity over the past two decades. The company entered into the high-margin brand licensing business, and has 13 signed projects as of today.
- **Online gaming.** The company acquired China's leading mobile game developer Yinhan Technology. We believe Huayi Brothers should be able to create synergies between its film IP and online game development.
- **Support from BAT.** Alibaba's founder, Jack Ma, and Tencent are the two biggest shareholders of Huayi Brothers. We believe the company is backed up by the strong financial resources and internet-related expertise of Alibaba and Tencent.

Valuation

Our RMB40 target price is DCF-based. We believe a DCF valuation, which captures the longer-term return, is the most appropriate for valuing Huayi Brothers, which should see sustainable growth, supported by its solid business structure with brand licensing and internet and mobile game development. Our WACC of 8.5% comprises our in-house estimated equity risk premium of 5.6% and risk-free rate of 3.9%. We assign a beta of 1.1, and a terminal growth rate of 4% for the strong long-term growth potential in China's media entertainment sector. The stock is trading at 49x 2016E EPS, implying a PEG of 1.6x on our two-year earnings CAGR. Although we like Huayi Brothers' fundamental and business structure, we think the share price has factored in the positives at the current level, and we therefore initiate at Hold.

Risks

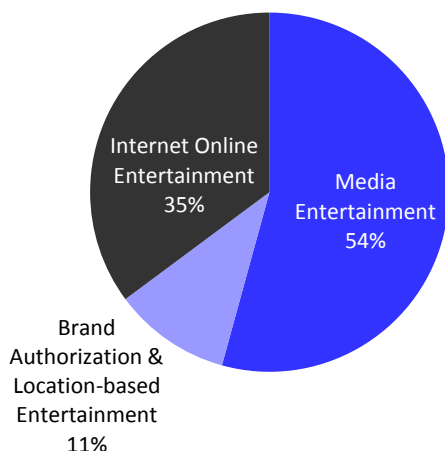
Key downside risks include 1) removal of favourable government policies, 2) intensified competition, 3) piracy issues in China, 4) lower-than-expected returns from film and TV drama productions, 5) delays in production, and 6) uncertainty in the new business. Key upside risks include better-than-expected box-office performances.



More than a movie maker

We disagree with the market's perception that Huayi Brothers is a pure movie maker. Huayi Brothers has gradually evolved into a comprehensive mass-media company through its years of work on movie production. If we look at the chart below, media entertainment (its traditional and core business, which includes movie production, TV series production, a talent agency service and a cinema business) accounted for only half of total revenue in 2014.

Figure 1: Huayi Brothers – revenue contribution mix, 2014



Source: Deutsche Bank, Company data

Started as a movie maker

No.1 movie producer in 2012 and 2013

In 2013, Huayi Brothers was still a pure movie and television series producer and distributor, with 97% of its revenues contributed by its media entertainment segment.

Huayi Brothers has been the leading private movie producer in China over the past few years. In 2013, movies produced by Huayi Brothers generated more than RMB3bn in box-office revenue, accounting for 14-15% of China's total box-office revenues and 25-30% of the domestic movie box office.

Reliance on movie quality and market feedback

Owing to its heavy reliance on movie production and distribution, Huayi Brothers' earnings have been relatively volatile, as revenues depend on the success of the movie productions, which are affected by various factors and are unpredictable at the investment stage.

Dependent on the talent of directors, producers and actors/actresses

Huayi Brothers has been highly dependent on one of China's famous movie directors, Mr. Xiaogang Feng (冯小刚), who is also one of the initial



shareholders of the company. Over the past decade, Mr. Feng has directed several successful movies, as shown in the table below.

Figure 2: Movies directed by Mr. Xiaogang Feng

Year	电影	Movie	Box office (RMBm)	Actors/Actresses
1997	甲方乙方	The Dream Factory	30-50	葛优 傅彪
1998	没完没了	Sorry Baby	30-50	葛优 吴倩莲 傅彪
1999	不见不散	Be There or Be Square	30-50	葛优 徐帆
2000	一声叹息	A Sigh	30-50	张国立 徐帆 傅彪
2002	大腕	Big Shot's Funeral	30-50	葛优 英达 关之琳
2003	手机	Cell Phone	30-50	葛优 徐帆
2004	天下无贼	A World Without Thieves	120	刘德华 刘若英 葛优 李冰冰
2006	夜宴	The Banquet	130	章子怡 吴彦祖 葛优 周迅 黄晓明
2007	集结号	Assembly	250	张涵予 廖凡 王宝强 邓超
2008	非诚勿扰	If You Are The One	325	葛优 舒淇 徐若瑄
2010	唐山大地震	After Shock	650	徐帆 陈道明 张静初
2010	非诚勿扰2	If You Are The One II	456	葛优 舒淇 孙红雷 姚晨
2012	一九四二	Back to 1942	371	张国立 陈道明 徐帆
2013	私人订制	Personal Tailor	713	葛优

Source: Deutsche Bank, Company data

In 2011, when the company released no movies directed by Mr. Feng, its movie production and related revenues declined 67% yoy. In 2013, the share price dropped 10% on 18 December and another 5.78% on 19 December, following the pre-screening of Mr. Feng's *Personal Tailor* to fund managers and investors.

Huayi Brothers' old business model, which relied heavily on the relationship with and the performance of famous celebrities, has been questioned by investors. The company's share price has also been affected by news on Mr. Feng and other celebrities. In December 2011, the stock declined for five consecutive days after actor Mr. You Ge (葛优) announced he was leaving Huayi Brothers, and in February 2012, the share performance was weak after Mr. Feng complained on his personal blog that he felt tired of directing movies.

Things have changed...

In our view, relying on its years of movie production, which kicked off with the cooperation with director Mr. Feng Xiaogang, Huayi Brothers has successfully accumulated the following assets:

- Huayi Brothers' own theatres in China.** Huayi established a theatre investment and management company in 2008, with the initial target of building six theatres in China. As of 1H15, the company had 15 theatres under operation.
- Huayi Brothers' own brand equity.** In the past two decades, Huayi Brothers has manufactured many classical movies that have changed China's domestic movie sector. As a result, Huayi Brothers' own brand equity is already a key intangible asset of the company. The company entered the brand licensing business in 2007, with the agreement with



Neo China Group, and officially launched this business segment in 2011. Brand licensing is a high-margin business (with a 100% gross margin). Currently, there are 13 sites that are authorised to use Huayi Brothers' brand name, including a brand licensing agreement with Mr. Xiaogang Feng's Movie Town Haikou.

- **Acquisition of Yinhan to enter online gaming business.** In 2013, Huayi Brothers announced that it was acquiring a 50.88% stake in Guangzhou Yinhan Technology (广州银汉科技), one of the leading mobile game developers in China. Popular mobile games that the company has developed include *Journey to the West*, *Space Hunter* and *Dreaming Journey*. The total consideration was RMB672m, which was paid with RMB448m of cash and the issuance of 7.6 million shares at RMB29.43.
- **Backed up by BAT.** As of 25 August, Alibaba's founder, Mr. Jack Ma, and Tencent are the two biggest shareholders of Huayi Brothers, after Mr. Zhongjun Wang and Mr. Zhonglei Wang, each with 8.06% holdings.
 - Mr. Jack Ma was a shareholder of Huayi Brothers before the IPO, with a 13.09% stake. As of December 2014, he holds 4.02% in Huayi Brothers.
 - Tencent invested RMB450m in Huayi Brothers for 4.6% ownership in 2011. According to Mr. Zhongjun Wang (even though he is not a board member), Tencent has been giving Huayi Brothers advice regarding investment in the internet industry. In August 2014, Tencent and Huayi Brothers announced an O2O entertainment social platform "Xingying Alliance" (星影联盟), which enables online interaction between celebrities and fans, as well as facilitating offline events.
 - On 25 August 2015, Huayi Brothers raised another RMB3.6bn through a private placement to four investors at RMB24.73. Alibaba and Tencent invested RMB1.5bn and RMB1.3bn, respectively. After the issuance, Mr. Zhongjun Wang and Mr. Zhonglei Wang's ownership in the company decreased to 26.87%, from 30.02%. Mr. Jack Ma and Alibaba hold 8.06% of Huayi Brothers, and Tencent holds another 8.06%.

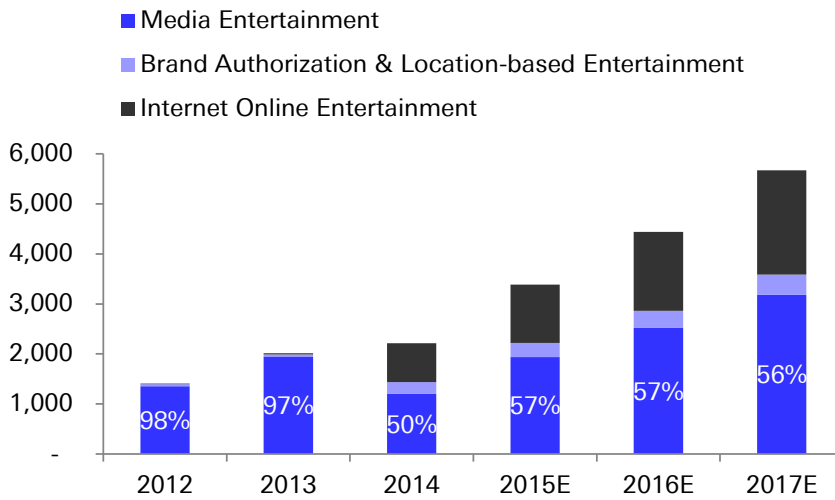
... and the company is relying more on film production

To build a more stable and sustainable structure, Huayi Brothers introduced the "Internet + Movies + Fans" strategy and started to build a stable triangular structure on movies, brand licensing and internet & mobile gaming.

With the support of brand licensing, location-based entertainment and internet-related business, we believe Huayi Brothers' earnings will not be strongly affected by the box office, and should see a more stable top-line and bottom-line performance in the future.

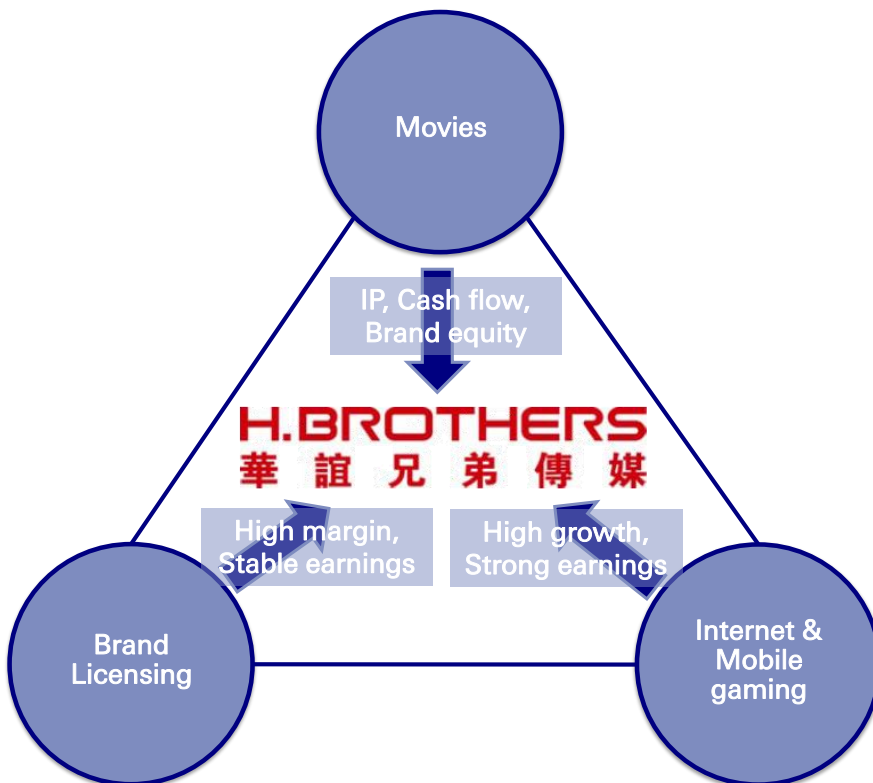


Figure 3: Rapid change in business structure in 2014



Source: Deutsche Bank estimates, Company data

Figure 4: Stable triangular business structure



Source: Deutsche Bank, Company data



Continuous investment in media entertainment content

- **Investment in Huayuxun (Maizuo.com 卖座网), 2014.** In 2014, Huayi Brothers invested RMB266m in Maizuo.com, an online movie ticketing platform, for a 51% stake in the company. Maizuo.com is one of the leading O2O movie platforms in China, with cooperation agreements with more than 700 large theatres.
- **Cooperation agreement with STX Entertainment, 2015.** In April 2015, Huayi Brothers formed a cooperation agreement with a US studio, STX Entertainment. According to the agreement contract, Huayi Brothers and STX will jointly produce and distribute 18 or more films by the end of 2017. Huayi Brothers will be responsible for film distribution in the Big China region.
- **Dongyang Haohan Media (东阳浩瀚影视娱乐), 2015.** In October 2015, the company acquired a 70% stake from six celebrity shareholders for a total consideration of RMB756m. The price converts into a PER ratio of only 12, which we believe is very attractive. According to the agreement, the six celebrities will generate at least RMB90m in net profit for the company in 2015, and achieve growth of 15% yoy over the next five years.

In 1H15, the company generated film-related revenue of c. RMB233m, representing a 57% yoy increase. According to Huayi Brothers' screening plan, another nine movies have been, or will be, in the cinema in 2H15. Following Huayi Brothers' production plans, the company will have a total of 18 films screening in 2015, compared with 10 films in 2014. As a result, we expect the company to achieve strong film revenue growth in 2H15 and full-year 2015.

Action and romance movies are two of the most well received movie types in China. Out of the 18 movies that Huayi Brothers released, or is to release, in 2015, seven (39%) are action movies, and another seven (39%) are romance movies.

Figure 5: Huayi Brothers' movie production and distribution list

	电影	Movies	Type	Release date	Box office (RMBm)
1	微爱之渐入佳境	Love on the Cloud	Comedy/Romance	Dec-14	285.13
2	功夫 3D	Kung Fu Hustle	Comedy/Action/Crime	Jan-15	25.56
3	奔跑吧兄弟	Running Man	Comedy	Jan-15	434.04
4	天降雄狮	Dragon Blade	Action/War	Feb-15	743.67
5	大囍临门	The Wonderful Wedding	Comedy	Mar-15	7.76
6	失孤	Lost and Love	Drama	Mar-15	20.20
7	白幽灵传奇之绝命逃亡	Outcast	Action	Apr-15	216.05
8	贵族大道	Mortdecai	Comedy/Action	Apr-15	22.79
9	少年班	The Ark of Mr. Chow	Drama/Comedy	Jun-15	50.64
10	栀子花开	Forever Young	Romance	Jul-15	na
11	命中注定	Only You	Comedy/Romance	Jul-15	na
12	太平轮·彼岸	The Crossing: Part 2	Drama/Romance	Jul-15	na
13	三城记	Tale of Three Cities	Drama/Romance	Aug-15	na
14	坏蛋必须死	Bad Guys Always Die	Drama/Comedy/Crime	Oct-15	na
15	别有动机	Ulterior Motive	Action/Crime	Nov-15	na
16	前任 2：备胎反击战	Ex-Files 2	Drama/Romance	Nov-15	na
17	寻龙诀	The Ghouls	Action/Horror	Dec-15	na
18	老炮儿	Fading Wave	Comedy/Action	Dec-15	na

Source: Deutsche Bank, Company data



Brand licensing

As of June 2015, Huayi Brothers had signed 13 brand licensing projects, including the following.

Figure 6: Brand licensing projects

项目	Project	Date
Signed		
苏州华谊影城	Suzhou Film Studios & Resorts	2011
深圳华谊兄弟文化创意产业	Shenzhen Culture & Innovation Industrial Park	2011
上海嘉定华谊兄弟文化城	Jiading Culture Center	2011
观澜湖华谊冯小刚电影公社	Movie Town Haikou	2012
华谊兄弟门里集团成都项目	Menli Chengdu project	2014
华谊兄弟门里集团北京项目	Menli Beijing project	2014
昆明项目	Kunming project	2015
华谊兄弟长沙电影文化城	Changsha Movie and Culture Resort	2015
郑州华谊兄弟电影文化小镇	Zhengzhou Movie and Culture Town	2015
重庆项目	Chongqing project	2015
华谊兄弟大理电影文化小镇	Dali Movie and Culture Town	2015
In discussion		
合肥项目	Hefei project	
杭州项目	Hangzhou project	
厦门项目	Xiamen project	

Source: Deutsche Bank, Company data

Internet entertainment + mobile gaming

In order to grow online, Huayi Brothers has been making a number of consolidation moves, which we believe should help the company to build a strong eco-system. Below are the investments Huayi Brothers has made over the past two years.

- Guangzhou Yinhan Technology (广州银汉科技), Internet, 2013.** In 2013, Huayi Brothers announced it was to acquire a 50.88% stake in Guangzhou Yinhan Technology, one of the leading mobile game developers in China. Popular mobile games the company has developed include *Journey to the West*, *Space Hunter* and *Dreaming Journey*.
 - Yinhan was consolidated into Huayi Brothers' internet online entertainment segment on 16 May 2014. In 2014, Yinhan contributed RMB507m in revenue, accounting for 65% of Huayi Brothers' internet business segment and 21% of its overall revenue. As a result, revenue from its internet-related business increased strongly, by 3222% yoy, to RMB778m, in 2014, and by 352% yoy, to RMB489m, in 1H15.
- Shanghai Haymaker Game (上海刃游网络科技有限公司), 2015.** Huayi Brothers announced in July 2015 that it was to invest RMB30m in Shanghai Haymaker Game for 10.33% of its stake. Haymaker Game is a mobile game developer and operator. Its developed mobile games include *Monkey King 3D* and shooting game *S.W.A.T*. In 2014, the company generated RMB21.35m in revenue and RMB6.63m in net profit.
- Strategic partnership with BesTV (600637.SS, NR), 2015.** Huayi Brothers has formed a strategic partnership with BesTV to develop the first TV to Online (T2O) interaction platform between fans and celebrities.

Figure 7: Yinhan – financial performance, 2014

RMBm	Yinhan	% of internet business	% of Huayi
Total asset	599	na	6%
Net asset	502	na	9%
Revenue	507	65%	21%
Net profit	235	na	23%

Source: Deutsche Bank, Company data



Figure 8: Investments in 2014 and 2015

公司	Company	Ownership %
2014		
北京捷特瑞影音科技	Beijing Jieterui Media Technology	30.00%
深圳市华宇讯科技 卖座网	Shenzhen Huayuxun Technology (which owns Maizuo.com)	51.00%
GDC Technology Limited	GDC Technology Limited	68.25%
北京摩点众筹科技	Beijing Modian Crowdfunding Technology	0.93%
新圣堂 (天津) 文化传播	Xinshentang Cultural Communication	65.00%
乐恒互动 (北京) 文化	Leheng Interactive Cultural	20.00%
易茗尚品 (天津) 电子商务	Yiming Shangpin E-commerce	19.60%
北京天赐之恒网络科技	Beijing Tiancizhiheng Internet Technology	15.00%
2015		
北京博派擎天创业投资中心	Beijing Bopai Qingtian Entrepreneur Investment	31.91%
苏州柒加壹	Suzhou Seven Plus one	5.00%
广州飞雨网络科技 (through 广州银汉科技)	Guangzhou Feiyu Internet Technology (through Guangzhou Yinhan Technology)	15.00%
北京无限自在文化传媒股份	Beijing Unlimited Freedom Cultural Media	5.00%
孚惠成长 (天津) 资产管理中心	Fuhui Development Asset Management	20.00%
上海投中信息咨询	Shanghai Touzhong Information Advisory	3.33%
东阳向上影业有限公司	Dongyang Shangxiang Film	13.00%
北京暴风魔镜科技	Beijing Storm Mojing Technology	7.92%
浅石创投 (杭州) 创业投资	Qianshi Venture Capital	19.00%
上海墨白计算机科技	Shanghai Mobai Computer Technology	10.00%
上海刃游网络科技	Shanghai Haymaker Game	10.33%

Source: Deutsche Bank, Company data



Valuation

Initiating with Hold and target price of RMB40

We initiate coverage of Huayi Brothers with a Hold rating and a DCF-based target price of RMB40. Our key valuation assumptions include the following.

- WACC of 8.5%.
- Targeting 70% equity for its capital structure, as guided by management. The company is in a net cash position at the moment.
- Cost of equity of 10.2%.
 - A risk-free rate of 3.9% and a market risk premium of 5.6% (in line with our in-house estimates).
 - A beta of 1.1 (Bloomberg three-year average).
- Cost of debt of 6.0% (our in-house estimate).
- A terminal growth rate of 4%.
- A tax rate of 25% (for terminal growth).

Figure 9: DCF assumptions

Our assumptions

Equity as % of capital structure	70%
Beta	1.1
Risk-free rate	3.9%
Equity risk premium	5.6%
Cost of equity	10.2%
Debt as % of capital structure	30%
Cost of debt	6.0%
Tax rate (for discount rate calculation)	25%
Terminal growth rate	4.0%
WACC	8.5%

Source: Deutsche Bank estimates

Figure 10: Our DCF valuation

RMB m	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Revenue	4,439	5,669	7,139	8,808	10,745	12,680	14,582	16,331	17,964	19,761
EBIT	1,506	1,923	2,410	3,000	3,671	4,345	5,011	5,629	6,209	6,850
Tax rate	19.1%	19.1%	19.1%	19.1%	19.1%	19.1%	19.1%	19.1%	19.1%	25.0%
Tax	(288)	(368)	(461)	(574)	(702)	(831)	(959)	(1,077)	(1,188)	(1,713)
NOPAT	1,218	1,555	1,949	2,426	2,969	3,513	4,052	4,552	5,021	5,138
D&A	101	124	150	180	193	203	233	261	287	316
Capex	(116)	(137)	(159)	(178)	(196)	(206)	(237)	(265)	(292)	(321)
Change in work. cap.	(555)	(680)	(798)	(835)	(967)	(888)	(729)	(817)	(898)	(988)
FCF	648	863	1,143	1,594	1,999	2,623	3,320	3,731	4,119	4,145

Source: Deutsche Bank estimates



Figure 11: Our DCF valuation, cont'd

Items (RMB m)	
Discounted FCF	55,497
WACC	8.5%
Net debt	2,456
Minority interest	(2,795)
Equity value	55,158
Shares outstanding (m)	1,389
Value per share (RMB)	40

Source: Deutsche Bank estimates

Sensitivity analysis between terminal growth and WACC

Figure 12: Sensitivity analysis

		WACC									
		6.5%	7.0%	7.5%	8.0%	8.5%	9.0%	9.5%	10.0%	10.5%	11.0%
Terminal Growth Rate	3.4%	63	54	46	41	36	32	29	27	24	22
	3.6%	67	56	48	42	37	33	30	27	25	23
	3.8%	71	59	50	44	38	34	31	28	25	23
	4.0%	76	63	53	45	40	35	31	28	26	24
	4.2%	82	66	55	47	41	36	32	29	26	24
	4.4%	89	71	58	49	43	38	33	30	27	25
	4.6%	97	76	62	52	45	39	34	31	28	25

Source: Deutsche Bank estimates

Alternatively – if we look at SOTP...still fully valued

China's entertainment sector is valued at a relatively high PER, at an average of 59x on 2016E EPS, owing to the structural growth ahead and supportive government policies. Among the listed A-share entertainment companies, Huayi Brothers is trading at 49x PER on our 2016E EPS, at a 16% discount to the peer average.

To cross-check, our PER-based SOTP valuation results in a price of RMB40, in line with our DCF valuation.

- The company guides Dongyang Haohan to generate RMB90m net profit in 2015 and RMB104m in 2016 (i.e. 15% yoy growth). This converts into RMB0.05 2016E EPS for Huayi Brothers.
- We allocate RMB0.76 2016E EPS (i.e. RMB0.81-RMB0.05) to the three business segments based on their gross profit breakdown, and assign a target PER to each business.
 - We assign a 50x target PER to Huayi Brothers' core media entertainment business, at a 15% discount to China's media industry.
 - We assign a 35x target PER to the company's brand licensing business, for its high barriers to entry, as the business can only be built on a well-known brand name.



- We assign a 50x target PER to Huayi Brothers' high-growth online business.
- In addition, Huayi Brothers holds 169 million shares in public listed company Ourpalm 掌趣科技 (300315.SZ, NR, RMB14.13) and 249 million shares in Guruonline 超凡网络 (8121.HK, NR, HKD0.35). The market values of the two companies convert into RMB2 per share.

Figure 13: SOTP valuation

	2016E EPS (RMB)	Target PER	Implied value per share (RMB)	2016-18E CAGR %
Media Entertainment	0.32	50x	16	24%
Brand Licensing	0.10	35x	3	15%
Internet Online Entertainment	0.33	50x	17	30%
Dongyang Haohan	0.05	35x	2	15%
Ourpalm (300315.SZ)			2	
Guruonline (8121.HK)			0	
Total	0.80		40	

Source: Deutsche Bank estimates

Figure 14: Comp sheet of China and global listed film/entertainment companies

Ticker	Company name	Current price	Market cap (USD m)	P/B	2015E PER	2016E PER	2015E EV/EBITDA	2016E EV/EBITDA	DB Recomm.
300027 CH Equity	HUAYI BROTHERS-A	39.72	8,683	5.6x	67.3x	49.5x	41.4x	31.3x	Hold
300133 CH Equity	ZHEJIANG HUACE-A	29.13	4,499	7.4x	69.1x	43.3x	54.6x	31.9x	Buy
300251 CH Equity	BEIJING ENLIGH-A	27.50	6,350	6.2x	89.5x	63.5x	64.6x	45.3x	Hold
002739 CH Equity	WANDA CINEMA L-A	101.21	17,854	23.6x	95.8x	60.2x	61.7x	35.8x	Buy
300291 CH Equity	BEIJING HUALUB-A	28.51	3,156	5.5x	56.3x	39.8x	49.0x	31.1x	NR
000802 CH Equity	BEIJING JINGXI-A	27.25	1,655	11.1x	113.5x	81.8x	44.0x	26.7x	NR
000719 CH Equity	CENTRAL CHINA-A	19.15	2,355	2.5x	66.0x	61.8x	6.4x	5.6x	NR
000156 CH Equity	WASU MEDIA HOL-A	27.69	6,201	4.4x	65.9x	52.2x	31.5x	29.8x	NR
300426 CH Equity	ZHEJIANG TALEN-A	69.23	1,731	24.0x	98.9x	75.3x	NA	NA	NR
Average				10.4x	80.1x	58.8x	41.8x	27.9x	

Source: Deutsche Bank estimates for covered companies, Bloomberg Finance LP for non-covered companies.





Our earnings forecasts

Consolidated income statement

- We estimate revenue to grow 42% yoy in 2015, to RMB3.4bn, driven by strong movie box-office performances, as well as the consolidation of Guangzhou Yinhan. We forecast revenue to increase 31% yoy in 2016, to RMB4.4bn, supported by the continuous booming of China's film and TV show industry and revenues from gaming.
- To be conservative, we forecast the gross margin to stay relatively flat, given the uncertainty in film and TV show production.
- We forecast core net earnings (excluding investment gains, which came in at RMB611m in 9M15,) to increase 21% yoy in 2015, to RMB776m. We estimate core net profit to grow 44% yoy in 2016, to RMB1.1bn, despite a 7% yoy decline in reported net profit due to the non-recurring investment gain in 2015.

Figure 15: Huayi Brothers' consolidated income statement, 2012-2017E

RMB m	2012	2013	2014	2015E	2016E	2017E
Revenue	1,386	2,014	2,389	3,389	4,439	5,669
Gross profit	702	1,008	1,455	2,030	2,664	3,402
SG&A	(400)	(401)	(573)	(884)	(1,158)	(1,478)
EBITDA	342	653	937	1,226	1,608	2,048
EBIT	302	607	882	1,146	1,506	1,923
Pre-tax profit	321	797	1,279	1,791	1,681	2,130
Net profit	244	590	897	1,202	1,114	1,413
Core net profit	219	433	639	776	1,114	1,413
EPS (RMB)	0.20	0.49	0.73	0.91	0.80	1.02
Core EPS (RMB)	0.18	0.36	0.52	0.59	0.80	1.02
Margin (%)						
Gross margin	51%	50%	61%	60%	60%	60%
SG&A as % of sales	-29%	-20%	-24%	-26%	-26%	-26%
EBITDA margin	25%	32%	39%	36%	36%	36%
EBIT margin	22%	30%	37%	34%	34%	34%
Tax rate	25%	25%	19%	19%	19%	19%
Net margin	18%	29%	38%	35%	25%	25%
Core net margin	16%	21%	27%	23%	25%	25%
YoY (%)						
Revenue	55%	45%	19%	42%	31%	28%
Gross profit	36%	44%	44%	39%	31%	28%
SG&A	47%	0%	43%	54%	31%	28%
EBITDA	27%	91%	44%	31%	31%	27%
EBIT	24%	101%	45%	30%	31%	28%
Pre-tax profit	17%	148%	60%	40%	-6%	27%
Net profit	20%	141%	52%	34%	-7%	27%
Core net profit	18%	97%	48%	21%	44%	27%

Source: Deutsche Bank estimates, Company data



Revenue

- Media entertainment. Revenues from Huayi Brothers' traditional media entertainment business include film-related revenue, movie-related revenue, talent-agency revenue and theatre revenue. We expect revenues from this segment to increase 61% yoy, to RMB1.9bn, in 2015, driven by a high number of films and TV shows, as well as strong box-office revenues.
- In 2015, Huayi Brothers will have had 18 movies showing in theatres, compared with 10 in 2014.
- Brand licensing. As Huayi Brothers is continuously signing new projects, we expect revenue from this segment to increase 22% yoy, to RMB285m, in 2015.
- Internet online entertainment. We expect revenue from this business to increase strongly, by 50% yoy, to RMB1.2bn, in 2015, owing partially to the consolidation of Guangzhou YinHan in May 2014.

Figure 16: Huayi Brothers' segment breakdown, 2012-2017E

RMB m	2012	2013	2014	2015E	2016E	2017E
Total revenue	1,386	2,014	2,389	3,389	4,439	5,669
Media entertainment	1,352	1,949	1,201	1,936	2,520	3,188
Brand licensing	43	42	234	285	343	401
Internet online entertainment	10	23	778	1,167	1,576	2,080
Revenue breakdown						
Media entertainment	98%	97%	50%	57%	57%	56%
Brand licensing	3%	2%	10%	8%	8%	7%
Internet online entertainment	1%	1%	33%	34%	35%	37%
Revenue yoy%						
Media entertainment	55%	45%	19%	42%	31%	28%
Brand licensing	61%	44%	-38%	61%	30%	26%
Brand licensing	13%	-4%	464%	22%	20%	17%
Internet online entertainment	-62%	127%	3222%	50%	35%	32%
Total gross profit						
Media entertainment	702	1,008	1,455	2,030	2,664	3,402
Brand licensing	601	957	533	869	1,140	1,441
Brand licensing	43	42	234	285	343	401
Internet online entertainment	10	22	576	875	1,182	1,560
			113			
Gross margin %						
Media entertainment	51%	50%	60.9%	60%	60%	60%
Media entertainment	44%	49%	44%	45%	45%	45%
Brand licensing	100%	100%	100%	100%	100%	100%
Brand licensing	100%	100%	100%	100%	100%	100%
Internet online entertainment	95%	92%	74%	75%	75%	75%

Source: Deutsche Bank estimates, Company data

Balance sheet and cash flow

- Huayi Brothers raised RMB3.6bn from a private placement, of which RMB3.1bn will be invested in media content production and RMB500m for the repayment of debt. We forecast Huayi Brothers to have net cash of RMB2.1bn and RMB2.5bn at the end of 2015 and 2016, respectively.
- We expect Huayi Brothers to maintain its current dividend payout of 14% over the next few years.



Figure 17: Huayi Brothers' balance sheet, 2012-2017E

RMB m	2012	2013	2014	2015E	2016E	2017E
Cash & equivalents	642	1,137	1,829	4,398	4,708	5,653
Account receivables	1,001	1,147	1,612	2,135	2,675	3,339
Pre-paid expenses	386	462	921	1,628	1,628	1,628
Other receivables	53	67	56	80	104	133
Inventory	701	575	816	1,117	1,459	1,863
Other current assets	12	4	15	172	172	172
Current assets	2,794	3,393	5,250	9,531	10,747	12,789
Available for sale	588	2,189	1,695	2,295	2,295	2,295
Long-term investment	386	878	784	693	703	703
Net PP&E	273	317	354	388	431	481
Construction-in-progress	-	-	-	-	-	-
Intangibles	-	2	74	70	67	63
Goodwill	33	354	1,486	1,726	2,472	2,472
Long-term deferred expenses	4	4	20	34	47	61
Deferred tax assets	28	35	89	89	89	89
Others	32	41	67	67	67	67
Long-term assets	1,344	3,819	4,569	5,362	6,170	6,231
Total assets	4,138	7,212	9,819	14,893	16,918	19,020
Short-term borrowing	593	668	785	1,370	1,564	1,802
LT debt due in one year	-	-	142	-	-	-
Accounts payable	496	501	311	452	591	755
Advance receipts	88	77	305	400	510	643
Accrued wages	4	5	24	30	30	30
Taxes payable	93	256	425	457	457	457
Other payables	46	137	321	335	438	559
Other current liabilities	300	600	600	-	-	-
Current liabilities	1,621	2,243	2,913	3,044	3,590	4,246
Long-term borrowings	300	502	849	913	688	876
Other non-current liabilities	93	508	377	377	377	377
Non-current liabilities	393	1,011	1,225	1,290	1,065	1,253
Total liabilities	2,013	3,254	4,139	4,334	4,655	5,499
Common shares	605	1,210	1,242	1,388	1,388	1,388
Additional paid-in capital	989	1,632	830	4,285	4,285	4,285
Reserve surplus	68	137	247	247	247	247
Retained earnings	458	964	1,836	2,914	3,862	5,120
Minorities	5	16	643	669	669	669
Others	-	-	881	1,056	1,812	1,812
Shareholders' equity	2,125	3,958	5,680	10,559	12,263	13,521

Source: Deutsche Bank estimates, Company data



Figure 18: Huayi Brothers' cash flow statement, 2012-2017E

RMB m	2012	2013	2014	2015E	2016E	2017E
Net income	244	590	897	1,202	1,114	1,413
Depreciation & amortisation	41	47	55	80	101	124
Change in working capital	(510)	144	(754)	(1,424)	(555)	(680)
Receivables	(637)	(160)	(454)	(547)	(565)	(693)
Inventory	(157)	126	(241)	(301)	(342)	(405)
Payables	299	96	13	162	241	285
Other current assets/liabilities	(14)	84	(72)	(739)	111	132
Other adjustments	(25)	(270)	(219)	109	74	67
Operating cash flow	(249)	511	(21)	(33)	735	925
Capital expenditure	(141)	(99)	(72)	(96)	(116)	(137)
Other long-term investments	(256)	(321)	304	(777)	(793)	(47)
Investment cash flow	(397)	(420)	232	(873)	(909)	(185)
Issuance (buyback) of shares	0	-	277	3,600	-	-
Issuance (repayment) of debt	893	579	296	(92)	(31)	426
Dividends	(91)	(164)	(220)	(124)	(167)	(154)
Others	(46)	(10)	133	92	682	(67)
Financing cash flow	757	404	486	3,475	484	205
Effect of exchange	-	-	(5)	-	-	-
Net change in cash	110	496	692	2,569	310	945
Opening cash balance	531	642	1,137	1,829	4,398	4,708
Ending cash balance	642	1,137	1,829	4,398	4,708	5,653

Source: Deutsche Bank estimates, Company data



Risks

Downside risks

- **Removal of favourable tax policies and/or government subsidies.** The government has favourable tax policies and offers subsidies to support industry growth. The removal of favourable tax policies and/or government subsidies could negatively affect Huayi Brothers' profitability.
- **Competition.** The movie and TV show industry is regulated by laws and policies, and companies are required to obtain corresponding licences to operate. As the government loosens industry policies, Huayi Brothers could face high competition.
- **Piracy.** Piracy has always been an issue in China, where unauthorised parties create copies without copyright. Pirated copies are distributed in the market at a significantly low cost, and this damages the operating environment of theatre circuits.
- **Lower-than-expected returns from films and TV shows.** Film production requires high initial investments, while the industry's revenues are highly dependent on the box office. Huayi Brothers may not be able to ensure positive market reactions and high box offices on its film and TV show investments, which could result in highly volatile earnings.
- **Delays in production.** Delays in releasing days, owing to production and/or distribution issues, could delay revenue recognition and cash generation, which would hurt Huayi Brothers' performance and might also result in delays in future investments.

Upside risks

- **Higher-than-expected box office.** Huayi Brothers could achieve higher-than-expected earnings growth if the company releases several box-office hits in a year and generates higher-than-expected returns from film investments.



Company profile

Business

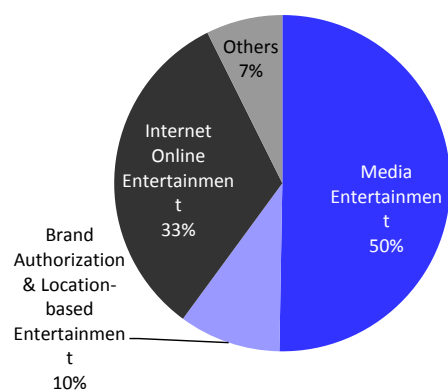
Huayi Brothers, headquartered in Beijing, was founded in 1994 by Mr. Wang Zhongjun and Mr. Wang Zhonglei. It is a leading private company in China's upstream film industry, and it operates three main business segments, including media entertainment, brand licensing and internet online entertainment.

Media entertainment is Huayi Brothers' core segment, accounting for 50% of total revenue in 2014; before 2014, media entertainment accounted for more than 90% of revenues. The media entertainment business is composed of four segments: 1) film production, distribution and related services; 2) TV show production, distribution and related services; 3) talent agencies and related services; and 4) theatre operations.

Over the past few years, the company has produced and distributed financially successful blockbusters including *Cell Phone* 手机, *A World Without Thieves* 天下无贼, *Rob-B-Hood* 宝贝计划, *Assembly* 集结号, *The Blood Brothers* 天堂口, *If You Are The One I&II* 非诚勿扰 I&II, *The Forbidden Kingdom* 功夫之王, and *The Message* 风声.

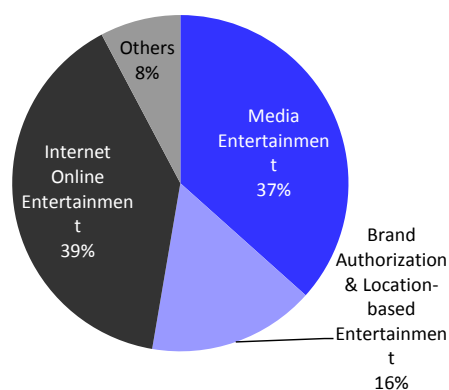
In 2014, Huayi Brothers' internet entertainment grew substantially, to RMB778m in revenues, and accounted for 33% of total revenues, owing to the consolidation of Guangzhou Yin Han Technology, a leading mobile game developer. Brand licensing and location-based entertainment increased 464% yoy in revenues, to RMB234m, in 2014.

Figure 19: Revenue breakdown, 2014



Source: Deutsche Bank, Company data

Figure 20: Gross profit breakdown, 2014



Source: Deutsche Bank, Company data



Management profile

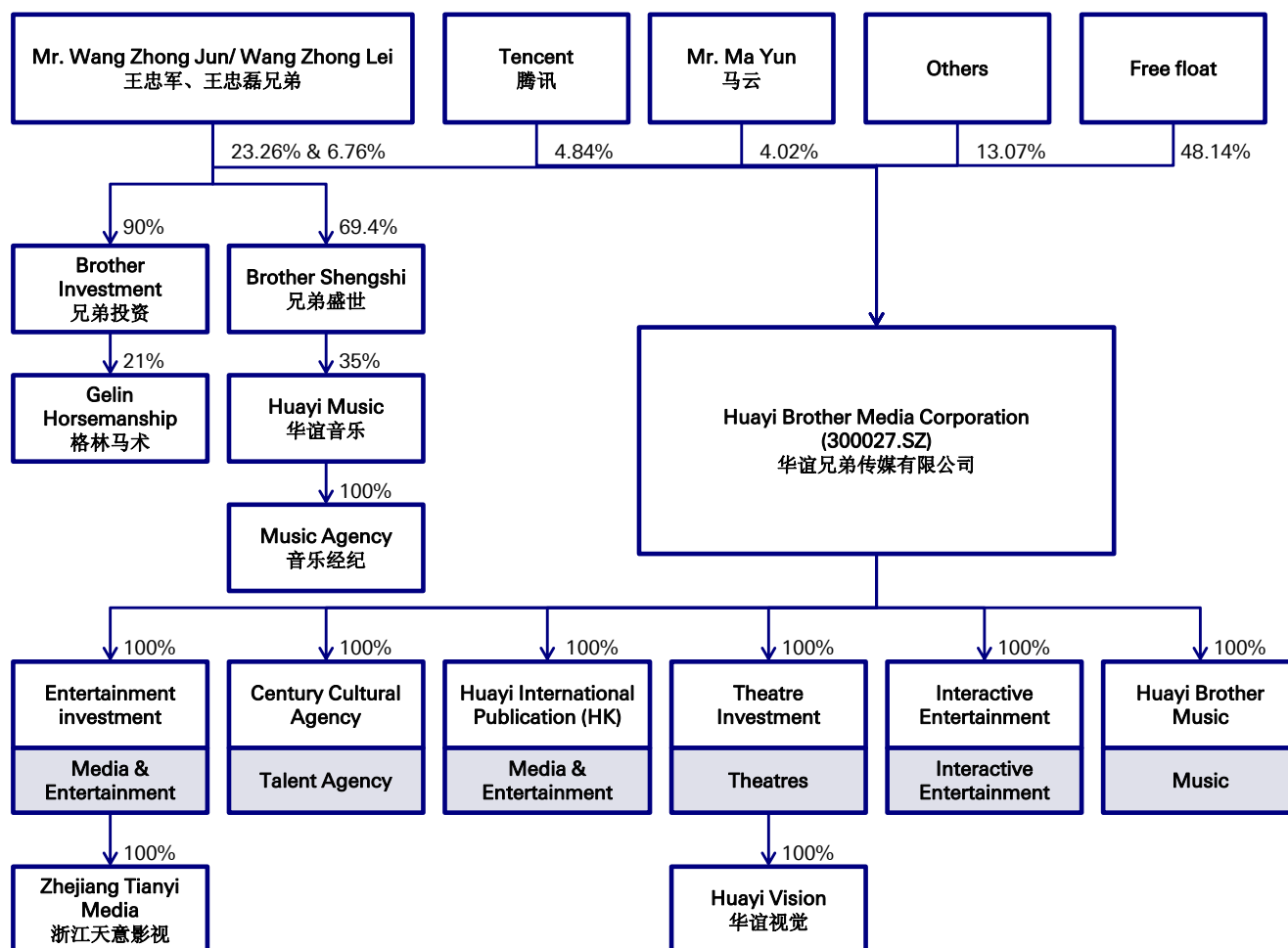
Figure 21: Management profile

Name	Position	Age	Salary in 2014 (RMBm)
Wang, Zhongjun	王忠军 Chairman & CEO	54	0.78
Wang, Zhonglei	王忠磊 Vice-Chairman & President	44	2.04
Liu, Xiaomei	刘晓梅 Board Director	52	na
Yu, Feng	虞峰 Board Director	51	na
Hu, Ming	胡明 Board Director & Vice-President	43	0.48
Ding, Qi	丁琪 Board Director & CFO	46	0.46
Kuang Na	匡娜 Board Secretary	32	0.26

Source: Deutsche Bank, Company data

Shareholding structure

Figure 22: Shareholding structure



Source: Deutsche Bank, Company data



Appendix 1

Important Disclosures

Additional information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
Huayi Brothers	300027.SZ	39.72 (CNY) 9 Nov 15	NA

*Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg and other vendors. Other information is sourced from Deutsche Bank, subject companies, and other sources. For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at <http://gm.db.com/ger/disclosure/DisclosureDirectory.eqsr>.

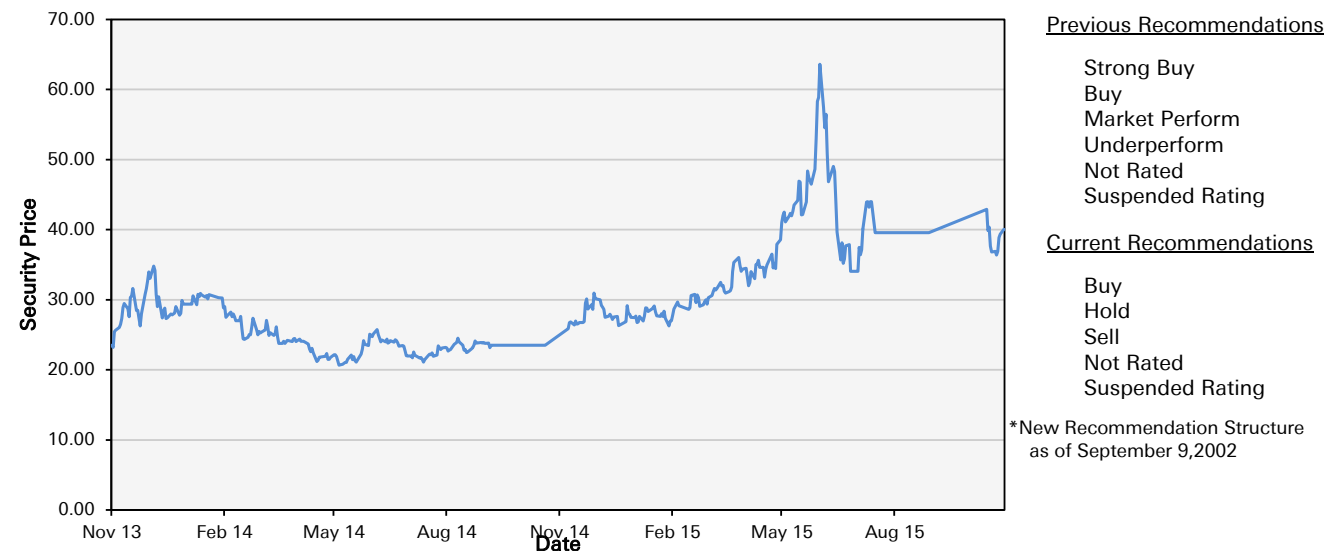
For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at <http://gm.db.com/ger/disclosure/Disclosure.eqsr?ricCode=300027.SZ>

Analyst Certification

The views expressed in this report accurately reflect the personal views of the undersigned lead analyst(s) about the subject issuer and the securities of the issuer. In addition, the undersigned lead analyst(s) has not and will not receive any compensation for providing a specific recommendation or view in this report. Tallan Zhou

Historical recommendations and target price: Huayi Brothers (300027.SZ)

(as of 11/9/2015)





Equity rating key

Buy: Based on a current 12-month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield), we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock.

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

Notes:

1. Newly issued research recommendations and target prices always supersede previously published research.

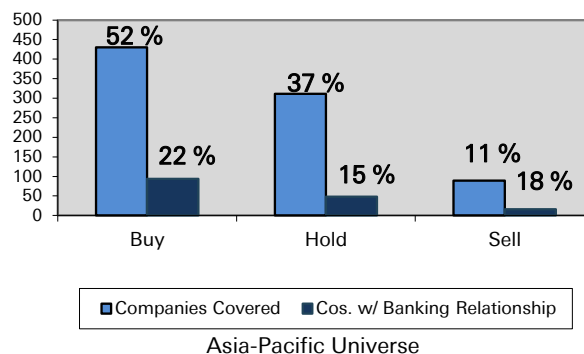
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Buy: Expected total return (including dividends) of 10% or more over a 12-month period

Hold: Expected total return (including dividends) between -10% and 10% over a 12-month period

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Equity rating dispersion and banking relationships



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